RJR

R.J.Reynolds Industries, Inc., 1973 Annual Report

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CORPORATION FILE

The men and women whose photographs are on the inside and outside of the front and back covers of this year's annual report are some of the more than 30,000 RJR employees from around the world who helped make 1973 a record year for our Company.

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HIGHLIGHTS

(Dollar Amounts in Thousands Except Per Share Statistics)

	1973	1972(1)	Percentage Change
FOR THE YEAR			
Net sales and revenues	$3,294,913	$2,957,630	+11.4
Net earnings	263,569	231,321	+13.9
Per common share	5.89	5.17	+13.9
Per common share—assuming full dilution	5.34	4.61	+15.8
Net earnings as a percentage of net sales and revenues	8.0%	7.8%	
Return on average total capital	15.6%	15.3%	
Return on average common stockholders' equity	18.1%	17.4%	
Capital expenditures	$ 339,729	$ 252,885	+34.3
AT YEAR-END			
Working capital	$ 720,473	$ 680,070	+5.9
Book value per common share	34.13	30.91	+10.4
Number of stockholders	124,371	120,321	+3.4
Number of employees	31,477	30,042	+4.8

(1) Restated for prior period adjustments. See Note F of Notes to Consolidated Financial Statements.

To the Stockholders

We are extremely pleased to report that consolidated sales and revenues and net earnings of your Company reached record levels again in 1973.

It is gratifying to report also that the record performance reflects a concerted effort by the management of all the subsidiaries to continue to improve their operations. We feel these improvements result, in part, from your Company's decision to establish R. J. Reynolds Industries as the new parent company in 1970. Under our present management structure, subsidiary management personnel now have more time to concentrate their attention in areas of their primary responsibilities with overall guidance and coordination being provided by parent company officers and special staffs.

Overall, the Company's record performance for 1973 showed net sales and revenues up 11.4 percent, earnings from operations up 7.4 percent, and consolidated net earnings up 13.9 percent, bringing net earnings per common share to $5.89 on a slightly greater number of shares outstanding. These figures are elaborated upon in the financial review which begins on page 15.

However, while the numbers are explained in more detail in the financial review, we do want to discuss at this point in our letter some of the activity behind the numbers.

The domestic growth rate of cigarette unit sales was at a high for recent years during 1973 and helped the industry attain record sales levels. Gratifying as this achievement is, the tobacco management team has continued to devote increased attention to the foreign cigarette market, which offers an even greater opportunity for sales increases.

Your Company's international tobacco operations enjoyed noteworthy success during 1973, and on February 15, 1974, just prior to the preparation of this letter, R. J. Reynolds Tobacco Company acquired Macdonald Tobacco Inc., one of Canada's leading tobacco manufacturers.

The acquisition of Macdonald Tobacco adds substantially to our international tobacco base. And, it further demonstrates the Company's intention to participate even more vigorously in the fast-growing international tobacco business.

We will continue to look for additional foreign growth opportunities in the tobacco area throughout 1974.

Sea-Land's contribution to the Company's overall performance is being affected by the expense and effort required to completely phase in the SL-7 fleet. However, the rigors and cost of deploying this fine fleet were not surprises. Indeed, your management was aware these conditions would arise when the commitment was made four years ago to build these ships. Let us assure you that the initial performances of these great vessels, even in their maiden year of operation, give every indication they will fulfill the expectations which led us to embark on their construction.

It is anticipated that earnings from operations from transportation will not begin to approach full potential until the SL-7 fleet is fully deployed and supplemented by the two new SL-18 class containerships due for delivery in the fall of this year. Management reached a deliberate decision to inject the new SL-7s into interim schedules with a major effort to secure revenues for these ships

COLIN STOKES

J. PAUL STICHT

while we continued to move toward optimum deployment. The significance of phasing in the new fleet is more fully discussed in the section of this annual report dealing with Sea-Land operations, beginning on page 9.

RJR Foods, the Company's foods and beverage subsidiary, emphasized last year the expansion of its beverage business and the strengthening of its convenience foods products. With this objective in mind, the Company earlier this year entered into an agreement for the sale of Filler Snacks and Caribbean Snacks. Your management feels it is advantageous for the Company to intensify efforts in convenience foods and beverages.

RJR Archer and Aminoil made significant contributions to the Company's overall success in 1973, and we plan to explore in depth a number of new opportunities to expand their operations during the current year.

Of course, the subjects of fuel supplies and energy conservation claimed a good deal of management attention throughout 1973. However, the fuel crisis did not catch us off guard.

Foreseeing, many months ago, the necessity to conserve energy, each of the Company's subsidiaries has been taking individual action for some time. Subsequently, in early November a comprehensive corporate-wide program was begun, under the direction of a special task force composed of engineering, manufacturing, communications and purchasing personnel.

Substantial savings are already being reported. For example, facilities in the Winston-Salem area alone have achieved a 3 percent reduction in energy use, equivalent to 6,200 tons of coal a year. A 10 percent cutback is expected by the end of next month. Such a reduction would mean the equivalent yearly saving of 100,000 barrels of oil or 20,000 tons of coal.

The success of our energy conservation programs is due to the wholehearted and enthusiastic support our employees, corporate-wide, have contributed to this effort.

Sea-Land Service, perhaps as intimately involved in the energy situation as any sector of the Company, charted its course toward energy management as early as July, 1973. A better than 15 percent reduction in energy usage at shoreside locations has already been achieved through the efforts of employees within the continental United States, Alaska and the Caribbean. More effective fleet deployment and closely timed arrivals have netted substantial savings in vessel fuel usage.

Of course, shortages of fuel and other materials could have an adverse effect on worldwide trade. Naturally, any significant decline in world trade may adversely affect international transportation. While we may also be affected, we believe we are postured to be affected somewhat less than the industry as a whole.

On April 25, 1973, A. H. Galloway retired as chairman and chief executive officer of R. J. Reynolds Industries, completing 44 years of service. From June, 1960, until he became the first chairman of newly organized Reynolds Industries in June, 1970, he was president of the Tobacco Company. We feel certain that you join us in expressing appreciation to Mr. Galloway for his valuable contributions to the Company's growth and progress. He has continued to serve as a member of the Board of Directors.

Immediately following Mr. Galloway's retirement, we were elected to our respective offices and charged with the leadership of the Company. From the outset we have tried to and will continue to be involved in all facets of the business. We are trying, as much as our schedules will permit, to visit operating units to assess problems and opportunities at their source. We feel we must meet the individuals and see conditions first-hand.

Additionally, we have begun encouraging far broader communication throughout the corporation and to its many publics. It is our intention to be as candid and informative as we can in presenting material about your Company.

The management resources of the Company's Board of Directors were expanded early this year when on January 17, 1974, the election of Herschel H. Cudd to the Board of Directors was announced. Mr. Cudd is president of Amoco Chemicals Corporation, which is a worldwide manufacturer and marketer of chemicals and plastics and a subsidiary of Standard Oil Company (Indiana).

In closing, we acknowledge with gratitude the loyalty and efforts of the Company's employees in making possible another record year. To you, the shareholders, we express appreciation for your encouragement and for your interest in the Company's progress.

Respectfully submitted for the Board of Directors,

Colin Stokes

Chairman, Board of Directors

J. Paul Stevall

President

February 20, 1974

RJR Products and Services

R. J. Reynolds Tobacco Company is the nation's leading manufacturer of cigarettes, including the popular **Winston, Salem, Camel, Vantage** and **Doral** brands, and also produces best-selling brands of smoking and plug chewing tobaccos and little cigars. Through its international operations the company's cigarette brands are sold in more than 110 countries around the world.

Sea-Land Service, Inc., provides containerized freight transportation to 111 port terminals in 45 countries, using more than 68,000 special containers and a fleet of 58 regularly scheduled containerships and 19 container relay vessels. Sea-Land's fleet includes the new SL-7 containerships, which provide the fastest containerized shipping service in the world.

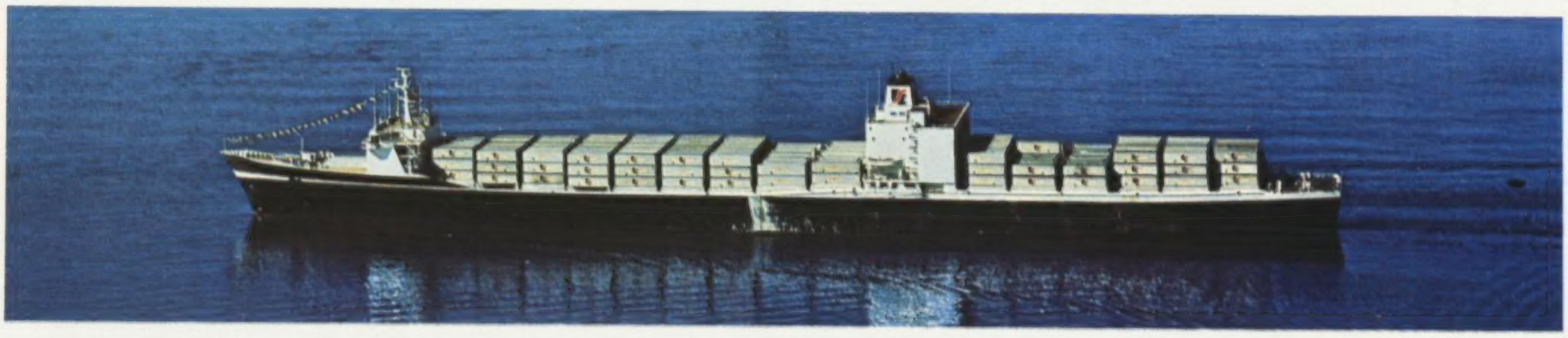
RJR Foods, Inc., makes a variety of foods and beverages, including many of America's long-time favorites and some of the newest, most innovative convenience foods on the market. Two of the company's most famous brands are **Hawaiian Punch,** one of the leading fruit beverages, and **Chun King,** the nation's No. 1 Oriental food line.

RJR Archer, Inc., produces gravure-printed, multi-layered packaging materials for many of America's best-known consumer products. Archer is also one of the nation's leading suppliers of specialty foil and sheet aluminum products, florist foil and protective film wrap, and makes household foil and gift wrap for major department stores and other private-label retail outlets.

American Independent Oil Company (Aminoil) is an independent oil producer and refiner selling primarily to other oil companies in the Far East and Europe. Aminoil's principal sources of oil are the Divided Zone between Kuwait and Saudi Arabia, and Iran. It has a refinery and desulfurization plant in Kuwait.

WINCHESTER
WINCHESTER
HUNDRED LITTLE CIGARS

APPLE
CARTER HALL
Prince Albert
PRINCE ALBERT
APPLE
BROWN'S MULE
OATS WORK
George Washington
TOP
CIGARETTE
TOBACCO


DAVIS
BAKING
POWDER
College Inn
CHICKEN
BROTH
Vermont Maid
Syrup
Bear Rabbit
MOLASSES
Bear Rabbit
MOLASSES
MY T FINE

CHUN KING
CHICKEN CHOW MEIN
CHUN KING
12 SHRIMP EGG ROLLS
PATIO
BEEF
ENCHILADA
DINNER
PATIO
12 MINI
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Chow Mein
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ARCHER
aluminum foil
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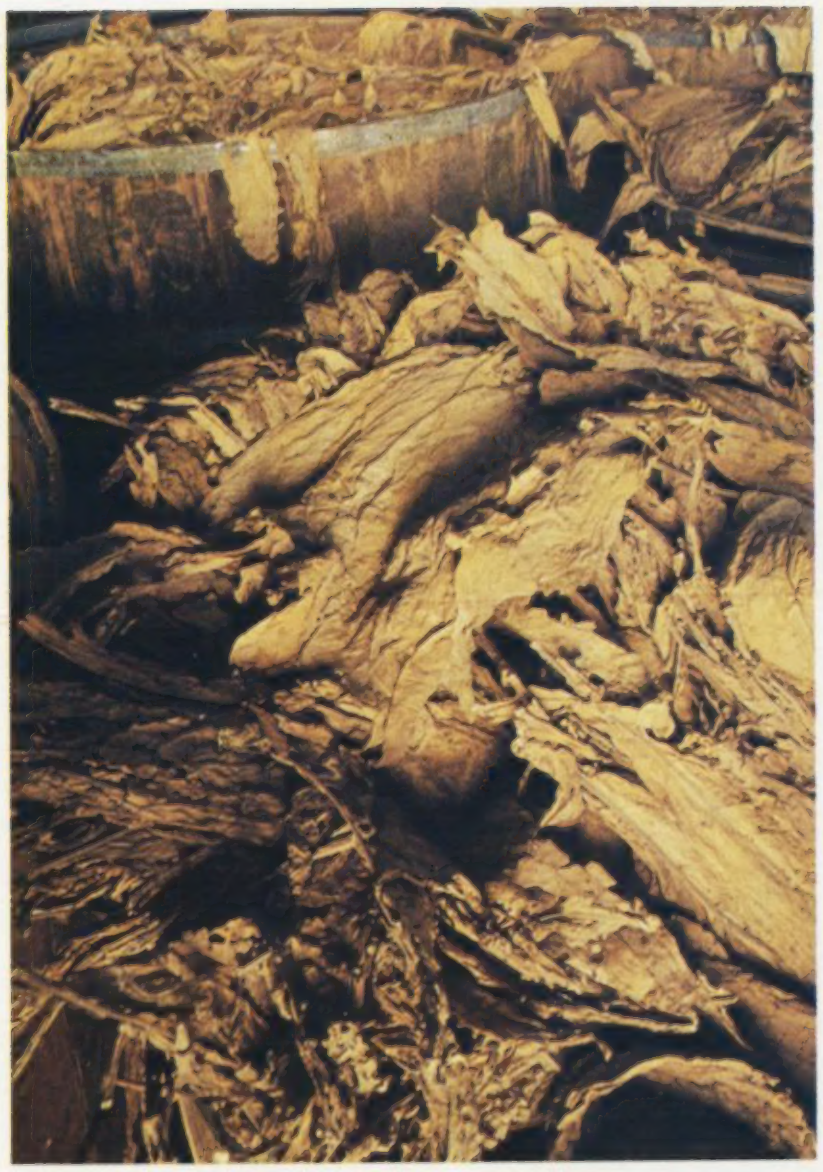


William S. Smith, Chairman (right), and Wm. D. Hobbs, President

R. J. REYNOLDS TOBACCO COMPANY

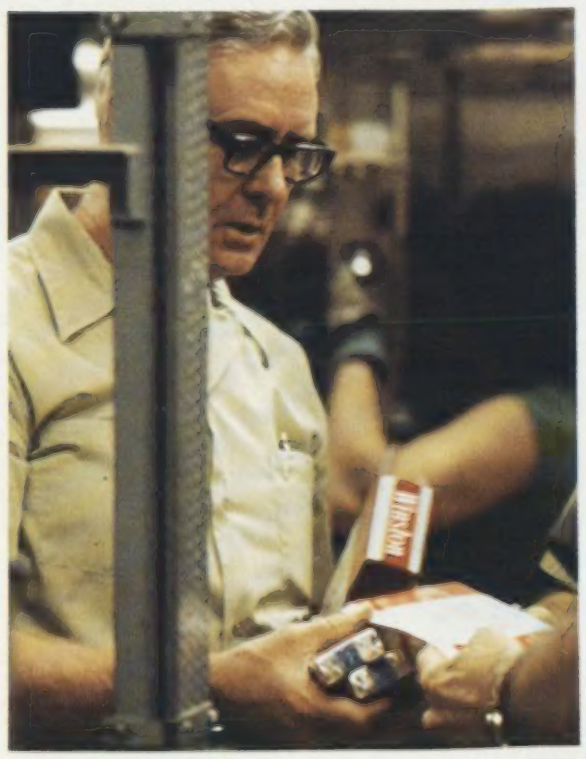
R. J. Reynolds Tobacco Company maintained its leadership in the domestic cigarette market in 1973 with record sales in a year which produced the greatest sales gain in recent history—about 4 percent—for the United States tobacco industry.

While three of the company's brands—**Winston, Salem** and **Camel**—were highly ranked among the top ten brands, the most notable growth rate was achieved by **Vantage,** one of Reynolds Tobacco's two successful entries in the low "tar" and nicotine category.

Tobacco industry analyst John C. Maxwell reported a 22.7 percent sales volume increase for **Vantage,** the fastest rate of growth among the top 20 brands and more than triple the average rate of growth for the five sales leaders. Total sales of 7.2 billion units placed **Vantage** in the 18th position among all brands after only three years in national distribution.

Significantly, **Vantage** is one of the few new brands to achieve consumer acceptance without a great deal of television advertising. **Vantage** commercials appeared for only two months after the brand's national introduction in 1970. Since the broadcast ban, the brand's growth has shown a direct relationship to its candid advertising approach in newspapers and magazines.

Winston, for which Maxwell



reported an overall sales increase of more than 2 billion units, remained the nation's best-selling cigarette for the eighth consecutive year. **Salem**, which also had a sales increase, was in fifth position.

Camel Regular, the all-time leading seller, celebrated its 60th anniversary during 1973. The company estimates that more than 3 trillion **Camel** cigarettes have been sold since the brand's introduction in 1913. **Camel** still holds the record for the most cigarettes sold by any brand in a single year, 105 billion in 1952. The regular non-filter category continued to decline, however, and Maxwell reported a drop of one position to seventh for **Camel** as increased sales by **Camel** Filter were more than offset by the decreasing demand for **Camel** Regular.

Doral, the company's other entry in the low "tar" and nicotine category, showed good sales gains during the second half of 1973 and ended the year with an overall increase.

According to the Maxwell report, **Winston** Super King was the leading non-menthol 100mm brand and **Salem** Super King was the leading 100mm menthol brand. Both brands had increased sales during the year.

Winchester, Reynolds' entry in the little cigar market, dominated its competition and accounted for nearly two-thirds of all little cigars sold.

"You're gonna like them Apples," the slogan used on commercials for **Apple** Pipe Tobacco, Reynolds' new aromatic blend, is apparently helping sell the brand to pipe smokers. The brand began its national introduction in September, and consumer response has exceeded expectations.

Prince Albert remained the top-selling smoking tobacco. **Carter Hall**, with increased volume in 1973, significantly outperformed the overall smoking tobacco market, which experienced declining sales.

Days Work led the plug tobacco market and continued to perform better than the declining plug category.

At Reynolds Tobacco, product quality has always been of utmost importance. In line with this philosophy, the company has begun the installation of a new generation of cigarette manufacturing equipment which will greatly increase production of a firmer, more uniform cigarette. This equipment includes a new line of cigarette makers, high-speed filter makers and a feeding system which allows the automated transfer of cigarettes from making machines to packing machines.

These machines will help Reynolds Tobacco meet the increasing demand for its brands while reducing manufacturing costs through increased productivity and improved quality. Although the new equipment will bring about reduced manpower needs, installation has been scheduled over a four-year period to allow normal attrition to maintain a balanced work force. When announcing the first phase of the installation, the company emphasized that no employee would lose his or her job as a result of the new machinery.

Ongoing brand development and improvement continued at the company's product development center during the year. The life span of successful tobacco products, as is true with most products, is very difficult to forecast. Thus, at the development center, studies are always under way to stay abreast of constantly changing smoker preferences. Through these efforts, as market characteristics change, Reynolds will be able to adjust its brands and

products to meet evolving consumer tastes.

Cigarette taxation remained a major issue facing the tobacco industry during 1973, with 20 state legislatures considering tax increase bills. However, only one proposal to increase a state's excise tax on cigarettes was passed, making the year the most successful in recent years for the industry in the taxation area.

It is a fact that when cigarette taxes reach exorbitant levels, sales drop, and lost sales are a damaging factor for every segment of the tobacco industry and all the businesses associated with it. Reynolds will continue to strongly support anti-taxation efforts through such organizations as the Tobacco Tax Council, Inc., and encourages its stockholders to actively lend their support by explaining to members of government the damaging effects of unfair cigarette taxation.

Jacques E. Borin, President, R. J. Reynolds Tobacco International, S.A.

INTERNATIONAL TOBACCO OPERATIONS

In international activity, R. J. Reynolds Tobacco International, S.A., continued its solid performance during 1973 with a growth rate nearly triple that of the overall world market, and R. J. Reynolds Tobacco Company announced late in the year it had agreed to acquire Macdonald Tobacco Inc., one of Canada's leading tobacco manufacturers.

Macdonald, with annual sales of approximately $250 million, is headquartered in Montreal, Quebec, and has been in operation in Canada for 116 years producing and distributing cigarettes, smoking tobacco and cigars. Its **Export "A"** is Canada's best-selling cigarette.

Reynolds Tobacco and Macdonald have participated in joint ventures in Canada since 1970, and Macdonald is the exclusive Canadian importer of Reynolds products.

In August, Reynolds International acquired a major interest in an Indonesian cigarette manufacturer, Industria Jaya. At the outset, P.T. R. J. Reynolds Indonesia will concentrate on providing local brands for the vast Indonesian market.

In Ecuador, Reynolds International launched a joint venture with El Progreso Company. A new

brand, **Full Speed Filter,** was introduced in September, and **Winston, Salem** and **Camel** Regular went into production in December in preparation for national distribution early in 1974. Also during 1973, an interest was secured in a small Venezuelan company. This acquisition provides Reynolds International with a means of manufacturing and distributing its brands in Venezuela, a country which does not now permit the importation of cigarettes.

The R. J. Reynolds interest in Capote, a Canary Islands manufacturing company (acquired in 1972) which supplies the Spanish market with black-tobacco cigarettes and a wide variety of cigars, provides the company with opportunities for greater participation in the Spanish market. The interest in Capote is significant to the company due to the fact that over 90 percent of the cigarettes sold in Spain are made with black tobacco.

Cost savings and marketing efficiencies were realized during 1973 through the purchase of St. James Tobacco, a cigarette distribution company in Australia which has handled the sale of R. J. Reynolds brands for several years. Similar advantages are expected in the Netherlands where R. J. Reynolds Tobacco B V was established to assume full marketing responsibilities from the former licensee, Theodorus Niemeyer, N.V.

The formation of R. J. Reynolds (U.K.) Ltd., was completed in 1973 to provide a base for coordinating the distribution of a cigarette made of Virginia-type tobacco and as a base for future activities in the United Kingdom.

Around the world, Reynolds International's existing brands continued to grow. To meet shifting consumer preferences, **Vantage** was introduced in Germany and Hong Kong, and **Camel** Double Filter, a new charcoal filter version of the brand, made its debut in Switzerland.

Strong sales gains in Italy, France and Spain necessitated strengthening the sales force in these high-market-potential countries. Additions were also made to the Hong Kong staff in order to continue the development of the company's business in Australasia, and a new office was opened in Rio de Janeiro, Brazil, to provide improved coordination of sales activities and further development in the fast-growing Latin American areas.

The company's new factories in Trier, West Germany, and Dagmersellen, Switzerland, were expanded during 1973, their second full year of operation. This expansion, combined with continuing increases in the export business, now provides the basis for the marketing of R. J. Reynolds brands in more than 110 countries. As anticipated, the factories at Trier and Dagmersellen have generated sizable cost reductions.

At the end of 1973, Reynolds International had licensing agreements in six countries: Austria, East Germany, Iran, Peru, Viet Nam and Yugoslavia. **Camel** Filter is being manufactured in East Germany and also has joined **Winston** and **Camel** Regular on the list of brands manufactured in Austria. Arrangements were completed with the Iranian and Yugoslavian governments to produce **Winston**, and negotiations were concluded with a company in Viet Nam to manufacture **Salem.**

Michael R. McEvoy, Chairman (left), and Paul F. Richardson, President

SEA-LAND SERVICE, INC.

The Sea-Land Service, Inc., fleet of eight SL-7 containerships became an operating reality during 1973, adding still another chapter to the company's reputation for leadership and innovation in the shipping industry.

With the phasing into service of six new vessels (the first two SL-7s entered service in 1972), the fleet quickly proved it has no peer in the commercial shipping industry—from the standpoints of both speed and efficiency.

However, it must be realized that the overall successful performance of Sea-Land depends on achieving optimum balance in the deployment of the company's entire fleet serving the world's trade routes in delicately synchronized unison.

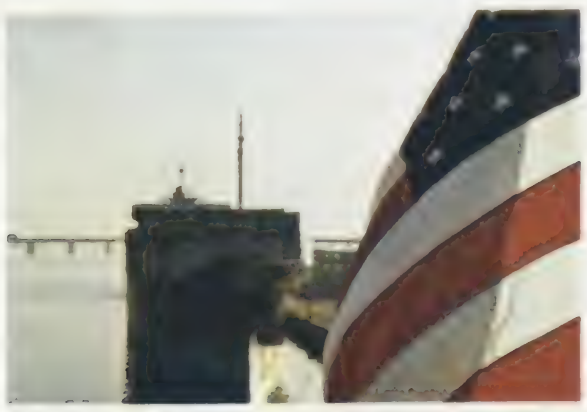
The projections and forecasts that led the company to embark on the SL-7 building program in 1969 were based on the potential efficiencies and capabilities of the eight vessels operating together with other existing and planned Sea-Land ships and port facilities. However, all eight SL-7s could not join the fleet simultaneously; rather, they were phased into service as they were completed over a 15-month period from late 1972 until last December.

Also having significant bearing on the ability of the SL-7s to operate as an integral fleet during 1973 (and still a factor in 1974) were the inspections, maintenance, dry-docking and adjustment tasks new vessels often require.

The final element necessary to complement the overall Sea-Land fleet before optimum utilization of the SL-7s can be achieved, will be the delivery of the two new SL-18 class vessels now being fitted to meet Sea-Land's container space requirements. These two new vessels, due to be delivered during the autumn of 1974, are sister ships to the two SL-18 class containerships presently operating between the Gulf ports of Houston and New Orleans and northern Europe. The SL-18s have a 733-container capacity and are capable of traveling at speeds up to 23 knots.

Once the remaining two SL-18s join the SL-7s and the rest of the Sea-Land containerships in full operation, Sea-Land will be able to offer shippers the utmost in frequent, scheduled, highly efficient container transportation. Indeed, the Sea-Land fleet will be second to none in the world in providing service that will compete most favorably for the cargos of world trade.

While the SL-7s were not fully deployed during 1973, the individual performance of these vessels has already more than proven their merits. In both transatlantic and transpacific service during 1973, the SL-7s, capable of carrying 1,096 containers at speeds up to 33 knots, broke every existing speed record for commercial cargo liners.



Even in their initial year of service, the SL-7s made a significant contribution to international trade, opening up a whole new market abroad for American commodities of limited shelf life, such as fresh produce from Southwest and West Coast regions of the U.S. The SL-7s are delivering these goods across the Pacific in approximately six days—a time span that competes favorably with air freight for delivery of fresh produce, but at substantially lower cost. Thus, the SL-7s enable these products to go on foreign markets at prices within the reach of more people.

Vessel deployment, however, is but one change at Sea-Land made necessary by the SL-7 fleet. Equally important in achieving the full benefits of this great new fleet are dock installations capable of assuring the 24-hour turnaround time of the SL-7s and even faster turnaround time for other Sea-Land containerships.

Sea-Land's program of expanding its support facilities was 90 percent completed during 1973. These facilities include the 232-acre complex at Elizabeth, New Jersey, where a new warehouse was nearing completion late in the year to handle the requirements of shippers of less-than-trailerload shipments. The new Elizabeth terminal facility accommodates 8,000 containers.

Also during the year, half a world away in Hong Kong, Sea-Land engineers completed still another new terminal facility. This Kwai Chung terminal provides space for more than 1,150 Sea-Land containers mounted on chassis as well as complete modern terminal and garage facilities.

During 1973, Sea-Land also continued to fill out its complement of support equipment and increased its number of containers to more than 68,000, including temperature-controlled containers, special automobile and livestock containers, much-sought-after bulk liquid tanks, and various other containers. By comparison, at the start of 1964 Sea-Land had less than 6,000 container units.

While this equipment was being added and installed throughout the year, the company continued to expand its routes and now serves 111 port terminals in 45 countries around the world. During 1973, port terminals were added to the Sea-Land system in Portugal, the Bahama Islands, Mexico and Costa Rica.

Naturally of prime concern during 1973 at Sea-Land was the situation regarding bunker fuel to operate the fleet. First, regarding availability of bunker fuel, Sea-Land was pleased with the Federal Energy Office's allocation of fuel for the shipping industry. Additionally, Sea-Land, prior to the energy crisis, secured long-term contracts with fuel suppliers. Of course, no one seems certain what may happen to bunker fuel prices or fuel availability. However, the Federal Maritime Commission has ruled that the maritime industry may add appropriate surcharges to its rates to adjust for rising fuel costs.

As early as mid-1973, Sea-Land voluntarily began a company-wide fuel conservation program and, wherever possible, reduced the operating speeds of its ships to increase fuel economy and still maintain all regular schedules.

Sea-Land activity during 1973 has poised the company, ready to launch a new era that will bring added dimension to the containerized shipping industry and help Sea-Land maintain its leadership in the maritime world.

S. A. Angotti, Chairman

RJR FOODS, INC.

RJR Foods, Inc., eliminated several marginal products during 1973 and, although revenues were down slightly, the company enjoyed one of the most profitable years in its history.

The company during 1973 gave particular emphasis to its beverage business.

Hawaiian Punch fruit punch made its debut in the soft drink sections of supermarkets and small retail outlets, and in vending machines, in New England. Formerly **Hawaiian Punch** products had been sold only in the fruit juice drink section of food outlets.

RJR Foods feels this expanded marketing and distribution offers greater long-term growth potential for **Hawaiian Punch,** which is among the best-selling fruit drinks.

The initial consumer acceptance of **Hawaiian Punch** in soft drink outlets has been excellent and during 1974 RJR Foods will broaden this effort.

In another area of the beverage industry last year, RJR Foods signed an agreement with Sunkist Growers, Inc., to develop and market packaged products under the famous **Sunkist** name. Sunkist is a marketing cooperative for more than 8,000 citrus growers in California and Arizona.

In early fall, RJR Foods began test marketing one product under the Sunkist agreement, and additional test activities are planned for 1974.

RJR Foods is confident that through the Sunkist agreement the company will become a strong factor in the growing frozen and packaged citrus products market.

During the year RJR Foods consolidated its **Chun King** canned foods plants into one facility. Canned **Chun King** products are now being manufactured exclusively in the expanded Cambridge, Maryland, plant. With the consolidation, the company phased out of service the old plant in Duluth, Minnesota. Significant technological improvements were achieved in the manufacture of the **Chun King** Oriental food line last year.

Chun King products—sold in both canned and frozen varieties—continued to be the nation's leader in the Oriental food line in 1973. The company's other principal brands—**Patio, Brer Rabbit, Vermont Maid, Davis, My*T*Fine** and **College Inn**—contributed significantly to RJR Foods' profit picture for the year.

To improve market penetration, RJR Foods shifted last year from a combination of brokers and a direct sales force to the exclusive utilization of food brokers throughout the United States. Brokers now represent the company in 72 major markets.

RJR Foods, Ltd., a Canadian subsidiary of the company, reported increased sales in 1973.

The Canadian company's **Swing** Orange Flavour Crystals (instant mix beverage) set new records during the year and continued to be among the leading fruit-flavored beverage mixes in Canada.

A new product, **Happy Hour** Snack Rolls, went into national distribution in Canada during the year. The frozen product, which comes in pepperoni pizza, western chili, beef & bar-b-que and sausage pizza flavors, met with enthusiastic consumer response, exceeding the most optimistic forecast of the company.

The company's **Coronation** brand of cherries, onions, olives and pickles continued to grow in popularity in Canada.

RJR Foods, Ltd., is looking forward to continued growth in Canada in 1974 on all existing product lines and has several new line extensions planned for introduction during 1974.

Jim Corrigan, Jr., President

RJR ARCHER, INC.

RJR Archer, Inc., reported record revenues in all its divisions for 1973 and closed the year with the largest backlog of orders in the company's history.

In fact, Archer's most persistent problem during the year was that the company was constantly operating at, or approaching, its production capacity. Quite simply, Archer could sell more goods than it was capable of producing.

Two principal factors explain why Archer has so rapidly approached the production capacity of its plants and equipment.

First, since the company became a wholly owned subsidiary of the RJR organization in 1967, its sales have more than doubled. And, second, while Archer is meeting the growing packaging demands of Reynolds Tobacco, it is also rapidly expanding its outside business, providing a broader range of products to an ever-growing list of customers. In the past eight years, Archer has shifted from doing one-third its business outside the RJR organization and two-thirds inside to its present ratio of selling two-thirds of its production to outside customers.

Archer feels its growth record further substantiates the reputation the company enjoys as an innovative producer of specialty aluminum and packaging products.

During 1973, the Packaging Division, a major supplier of flexible packaging to the food, drug, film and tobacco industries, posted significant gains in volume, and operating results reflected improvements in efficiencies, equipment utilization and product mix.

The Metals Division operated its three aluminum sheet and foil plants at full capacity for the entire year. Rising costs of raw materials were passed through to customers as permitted by the Cost of Living Council. This division also made improvements in operating efficiencies and product mix.

The Consumer Division's Greeneville, Tennessee, facility was improved and the Biola, California, plant completed its first full year of operation. With these plants on both the East and the West coasts, staffed with experienced personnel, the division now provides nationwide service to customers that is unique in the gift wrap, florist foil and household foil industry.

The Filmco Division's film wrap operations were affected by a worldwide shortage of polyvinyl chloride resin during 1973, but both the Aurora, Ohio, and the Sedgefield, England, plants improved performance for the year.

At the close of the year, Archer management was completing a comprehensive development plan aimed at increasing production capacities to accommodate its growing orders.

J. B. Sunderland, President

AMINOIL

With international attention suddenly focused more than ever on the world's oil supply, American Independent Oil Company (Aminoil) has gained even greater significance as an important member of the R. J. Reynolds corporate family.

Although of modest size when compared to the leaders in the petroleum industry, Aminoil continued to play a vital role in the Reynolds Industries organization during 1973, and despite the situation in the Middle East the company posted significant gains in revenues and earnings.

Kuwait, where the company maintains its principal holdings, is one of the Arab countries that imposed a total embargo on oil shipments to the United States and the Netherlands, but Aminoil was not greatly affected since the company markets most of its products in the Far East and Europe. The embargo of the Netherlands had only minimal effect on the company.

Due to the conflict in the Middle East, the company was required by the local government to reduce production in Kuwait after October 18, by 22 percent. The company's Kuwait shipments during 1973 averaged 73,200 barrels per day, but at the close of the year it was apparent that if the production restrictions were not lifted, shipments for 1974 might decline to about 59,000 barrels daily.

In Iran, where Aminoil holds a minority interest in the Iranian Consortium, negotiations concerning a sales and purchase agreement were completed with the government. The company's shipments were 42,000 barrels per day from Iran.

Development drilling continued during 1973 on the Louisiana offshore gas discovery in which Aminoil has a small interest. Sales of gas from this discovery are scheduled to begin in 1975. Exploration continued in 1973 in Indonesia. One dry hole was drilled offshore Indonesia in the Sunda Strait during the year.

During 1973, the company added to its exploration staff and will continue to search for new oil sources. An agreement was signed during the year giving Aminoil a small interest along with other companies for rights to explore and drill on a second 5,000-acre Louisiana offshore tract. Late in 1973, Aminoil joined a group of companies in making joint application for a license to conduct oil exploration activity in the North Sea.

Aminoil foresees substantial opportunities in the coming year as international demand for oil continues to mount, and the company will continue to seek out new sources of oil throughout the world.

Financial Review

Summary

Net sales and revenues in 1973 were $3.29 billion, an increase of 11.4% over 1972, marking the first time in the Company's history that sales and revenues have exceeded $3 billion. Net earnings also increased to a record high of $264 million, a gain of 13.9% over 1972. Net earnings per common share increased to $5.89 from $5.17 on a slightly greater number of common shares outstanding in 1973.

Of the net earnings increase in 1973, $20 million was due to higher investment tax credits related to capital expenditures in the transportation business. The Company uses the flow-through method in accounting for investment tax credits, whereby the provision for income taxes is reduced in the year the tax credit first becomes available. The favorable effect of investment tax credits was offset in part by interest expense which increased $10 million over 1972 due primarily to the long-term financing of the new SL-7 vessels.

During the past ten years net earnings have increased at an average annual compound rate of 7.5% while sales have grown at 6.2%. Over the past five years net earnings have risen at an average annual compound rate of 9.3% and the sales growth has been 7.8%.

As explained in Note F of Notes to Consolidated Financial Statements, adjustments have been made to amounts previously reported for the twelve years ended 1972 to reflect settlement of an issue with the Internal Revenue Service. The issue concerned the manner in which the Company applied the last-in, first-out (LIFO) method of pricing inventories in its tobacco business and resulted in a $19 million net refund of federal income taxes and interest.

Net Sales and Revenues

The improvement in consolidated net sales and revenues for the year reflected increases in tobacco, transportation, petroleum, and aluminum products and packaging operations. Tobacco sales increased 8.4% as a result of higher unit sales and certain price increases late in the first quarter of 1973, including a two percent increase in domestic cigarette prices. Tobacco sales included federal and foreign excise taxes of $965 million in 1973 and $885 million in 1972.

Transportation revenues increased 29.2%, due principally to the phase-in during the year of the new SL-7 containerships and improved rates on certain trade routes.

Aggregate sales of the Company's other businesses category increased 7.1% over 1972. The aluminum products and packaging and petroleum businesses reported increases over 1972. Sales of the foods business declined slightly from 1972, primarily due to the discontinuance of low-volume products with unsatisfactory margins.

NET SALES AND REVENUES

(Dollars in Thousands)

	1973	%	1972	%
Tobacco	$2,349,617	71.3	$2,168,242	73.4
Transportation	582,631	17.7	450,886	15.2
Other	362,665	11.0	338,502	11.4
Consolidated	$3,294,913	100.0	$2,957,630	100.0

Earnings from Operations

Tobacco earnings from operations rose 7.4% over 1972 as a result of higher cigarette unit sales and a stronger showing by the Company's international operations. The effect of the first quarter price increase on tobacco products was more than offset by cost increases. The major cost increase was a 7% rise in leaf tobacco costs during the 1973 leaf-buying season. The Company values its tobacco inventories using the LIFO method, thereby charging increased costs against earnings immediately rather than deferring them to later periods.

Transportation earnings from operations declined $15 million from 1972 as start-up costs of the new vessels and higher operating costs of the entire transportation business more than offset the effect of revenue gains.

Earnings from operations of the Company's other businesses increased 41% over 1972, reflecting higher sales of petroleum products and aluminum products and packaging and cost reductions in the foods business.

EARNINGS FROM OPERATIONS*

(Dollars in Thousands)

	1973	%	1972	%
Tobacco	$434,227	82.7	$404,487	82.8
Transportation	16,535	3.2	31,688	6.5
Other	74,048	14.1	52,489	10.7
Consolidated	$524,810	100.0	$488,664	100.0

*Earnings before interest and debt expense, other income and expense, and provision for income taxes.

Dividends

The Company increased its quarterly dividend on Common Stock to $.648 per share in January, 1973, and to $.67 per share in July, 1973. Except for 1971, when dividend increases were effectively prohibited by federal economic guidelines, the Company's dividend per common share has increased each year for the past 20 years.

Dividends per common share as a percentage of earnings per common share before extraordinary items have averaged 56% for the past ten years and 50% for the last five years. Dividends declared on the Common and Preferred Stocks during the year aggregated $127 million, the highest for the Company's 74 consecutive years of dividend payments.

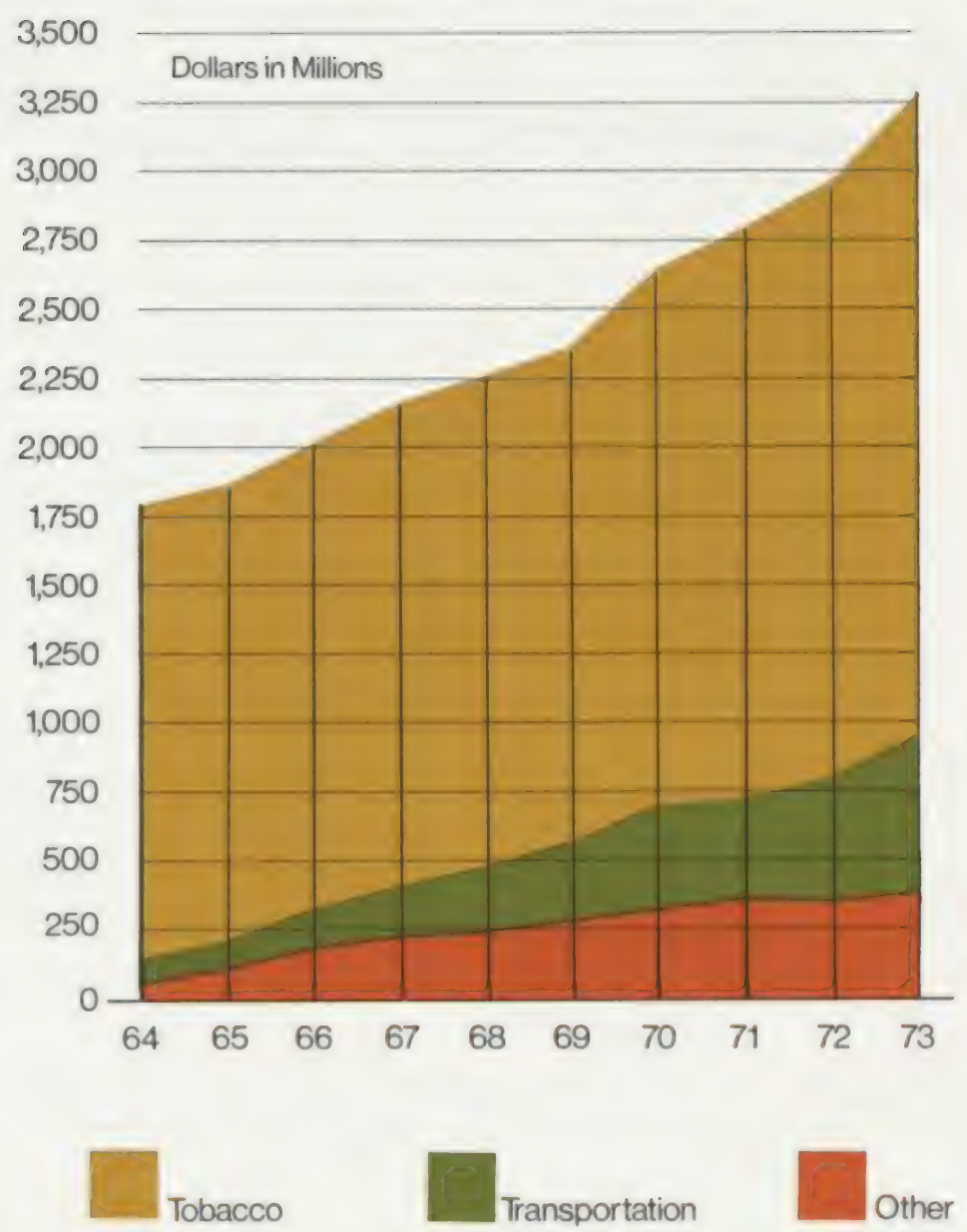
Debt Position

Long-term debt at year-end (including current maturities) amounted to $563 million, after repayments of $55 million during the year. In December, 1973, the Company accepted delivery of the eighth SL-7 super containership, completing that major shipbuilding program. All construction loans related to this program have been replaced by long-term ship mortgage bonds. Ship mortgage bonds totaled $267 million at year-end. Additional debt information is contained in Note B of Notes to Consolidated Financial Statements.

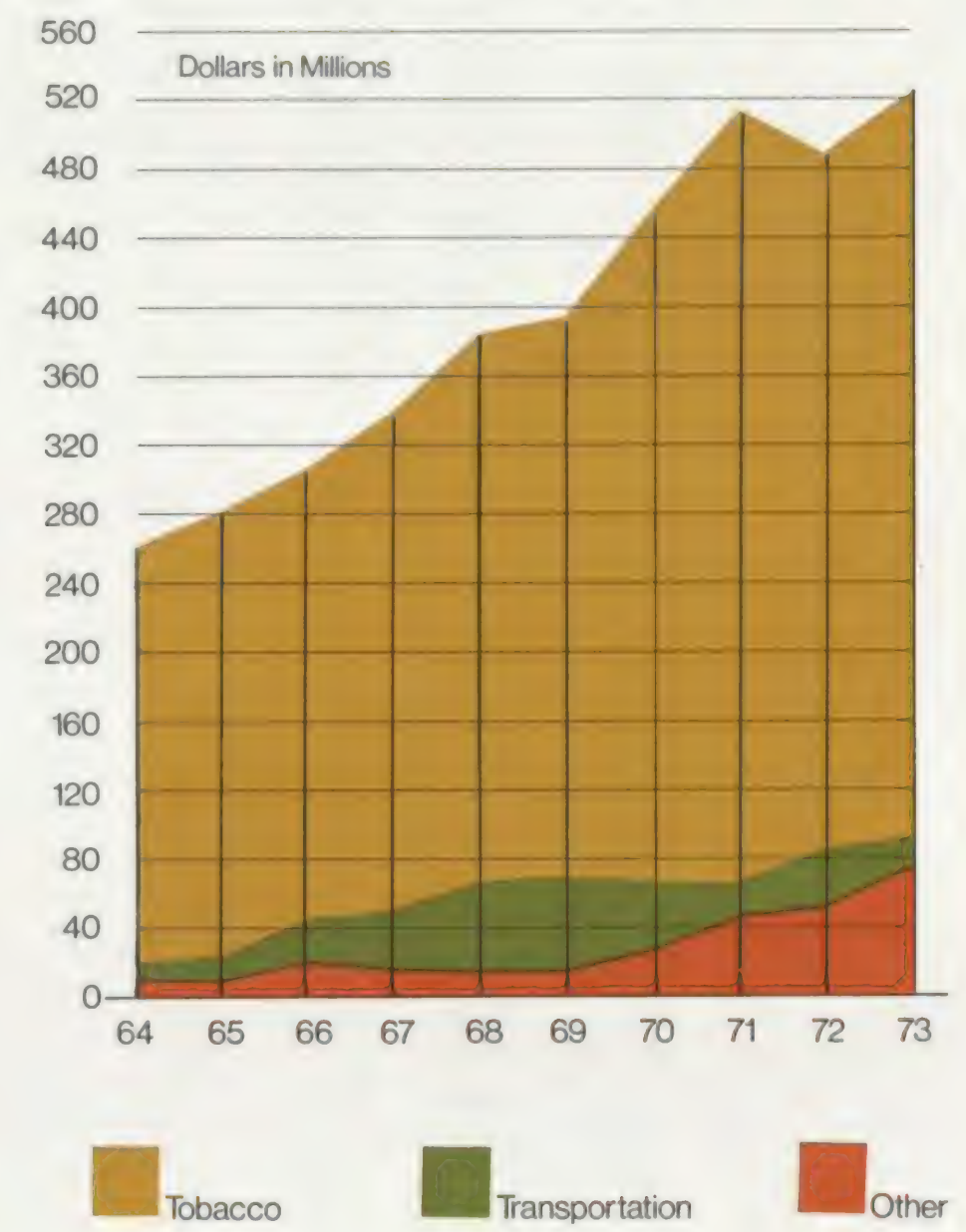
Year-end short-term notes payable were $47 million. The Company's domestic operations were free of short-term indebtedness during a major portion of the year. At year-end the Company had available unused bank lines of credit totaling $248 million.

At year-end 1973 the Company's total debt equalled 28.8% of total capital (the sum of stockholders' equity, long-term debt, and notes payable). Total debt as a percentage of total capital has averaged 26.0%

Net Sales and Revenues



Earnings from Operations



for the past ten years and 29.2% for the last five years.

Capital Expenditures

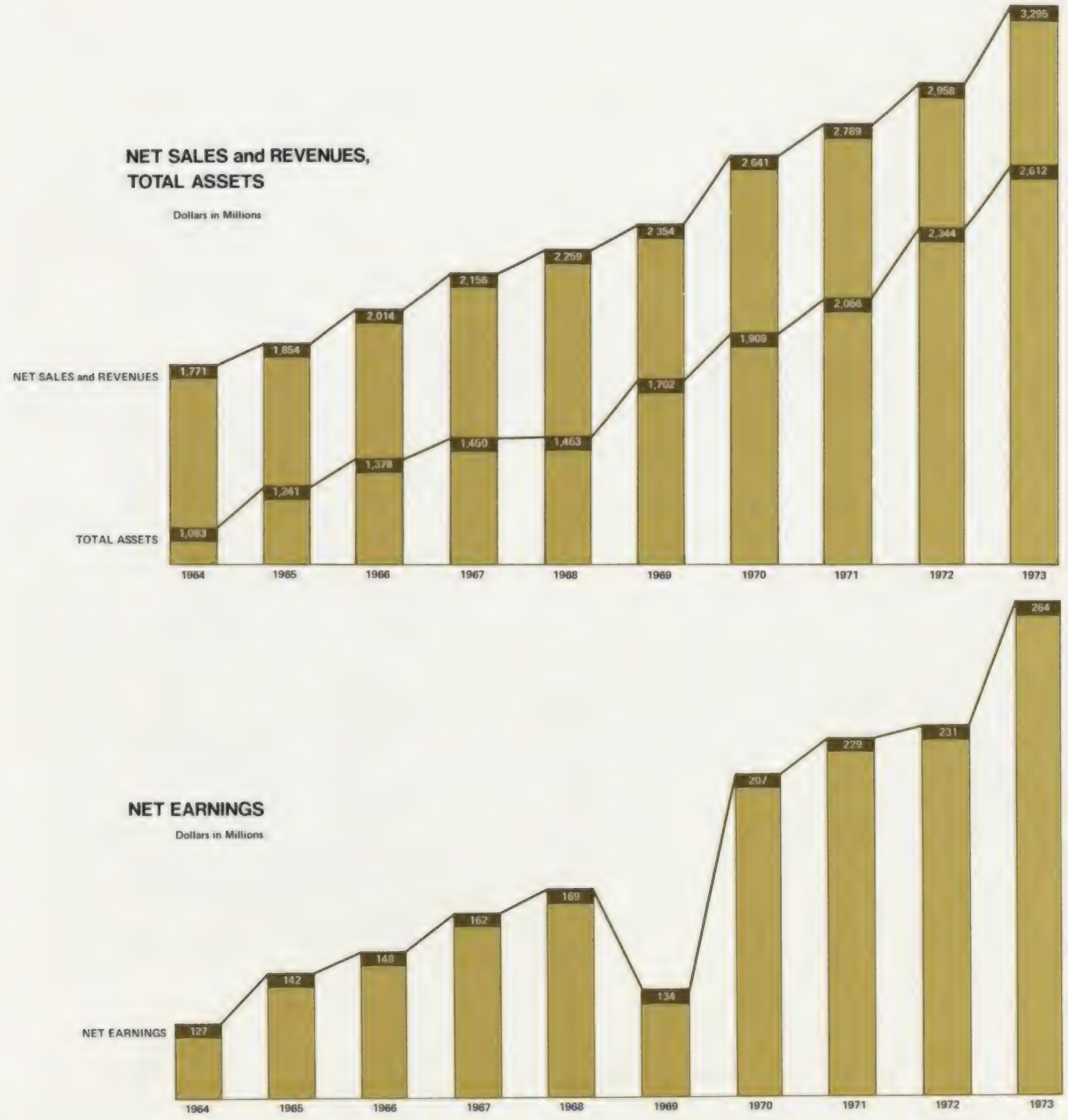
Capital expenditures in 1973 were $340 million, compared to the 1972 total of $253 million. Acquisition and construction of vessels and purchase of associated equipment to expand Sea-Land's containership fleet accounted for 91% of the 1973 expenditures. The 1973 amount exceeded the original estimate for the year due principally to the higher dollar cost (because of the U.S. dollar devaluation) of the Company's foreign shipbuilding program and the expenditure of $28 million toward the purchase of two new SL-18 type vessels now nearing completion in United States shipyards. The two new vessels, which are expected to be placed in service during the last half of 1974, have a capacity of over 700 containers each and a rated cruising speed of 23 knots.

During the past five years, capital expenditures have totaled over $1.1 billion. Slightly more than half of these expenditures were financed with funds generated from internal sources. The major portion of the expenditures related to the SL-7 program which began in 1969 and was virtually complete by year-end 1973. This expansion in the Company's transportation business has involved a long construction period during which there were substantial outlays of Company funds with little related addition to revenues and earnings.

Capital expenditures in 1974 are currently estimated at $140 million and will be primarily for replacement and modernization of existing equipment and facilities throughout the Company's businesses. It is presently anticipated that this amount will be representative of the Company's annual capital expenditures over the next three years.

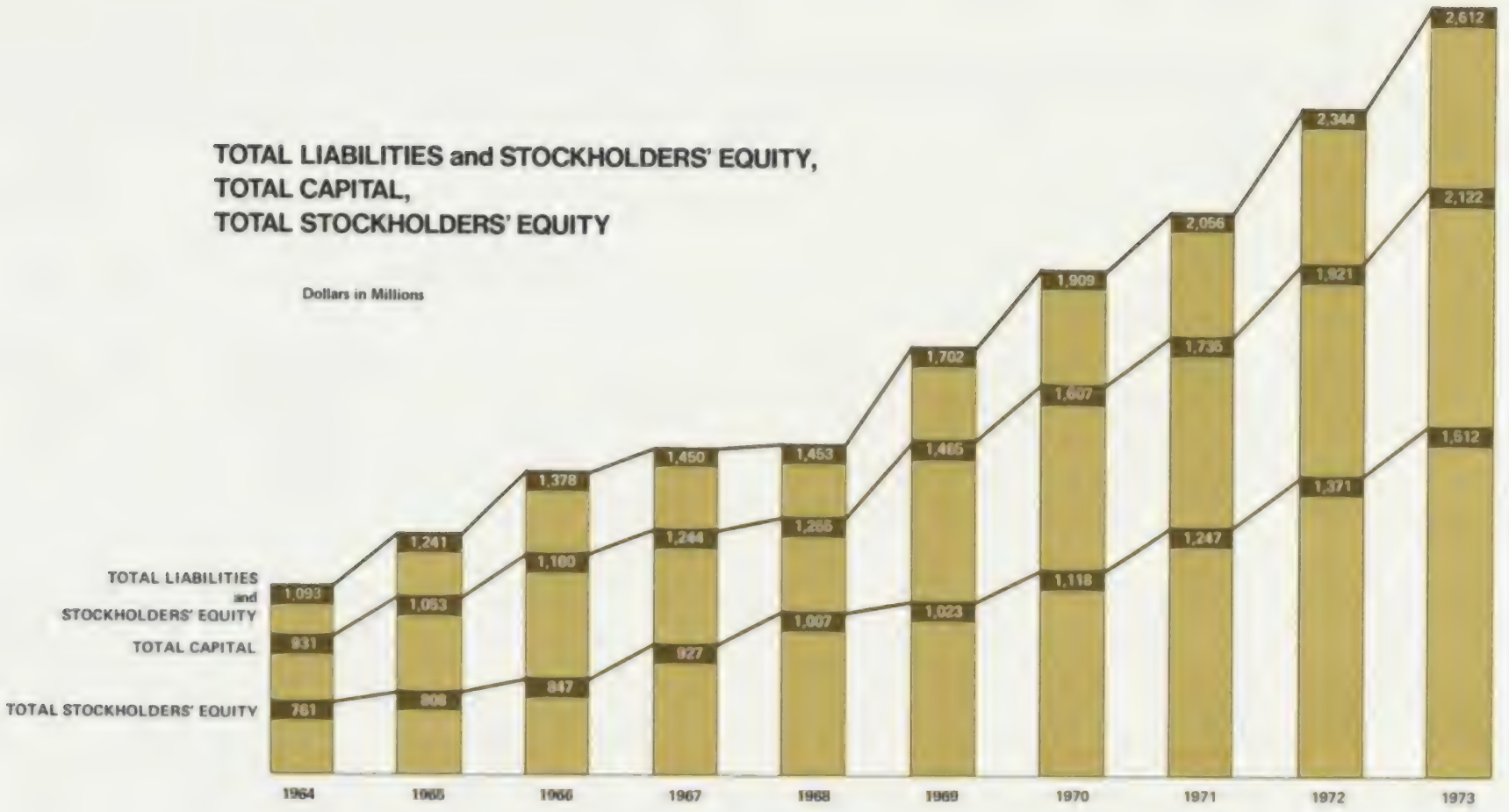
Acquisition

On February 15, 1974, the Company acquired, for $75 million, the stock of Macdonald Tobacco Inc., a Canadian tobacco manufacturer with annual sales of approximately $250 million.



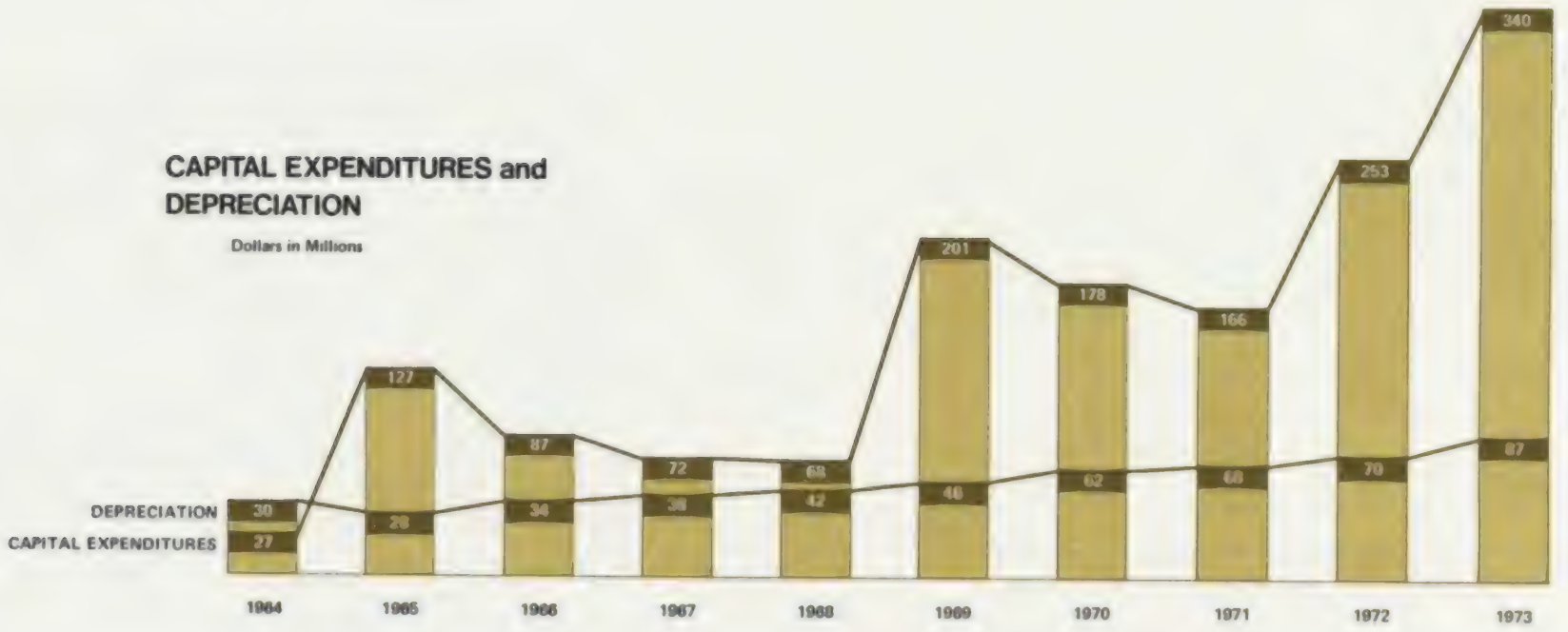
TOTAL LIABILITIES and STOCKHOLDERS' EQUITY, TOTAL CAPITAL, TOTAL STOCKHOLDERS' EQUITY

Dollars in Millions

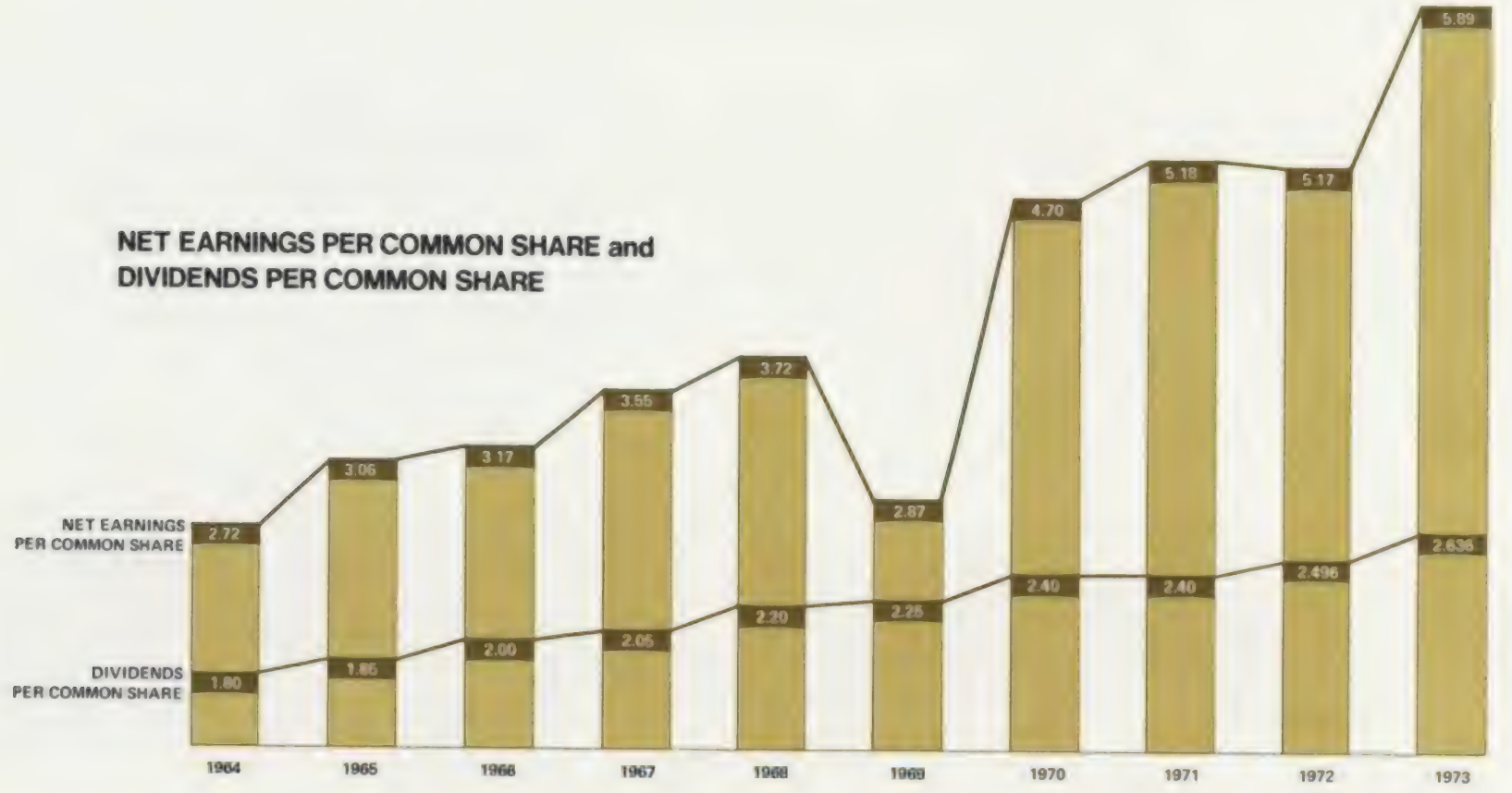


CAPITAL EXPENDITURES and DEPRECIATION

Dollars in Millions



NET EARNINGS PER COMMON SHARE and DIVIDENDS PER COMMON SHARE



TEN-YEAR CONSOLIDATED FINANCIAL SUMMARY[1]

(Dollar Amounts in Thousands Except Share Statistics)

Year Ended December 31	1973	1972	1971
RESULTS OF OPERATIONS			
Net sales and revenues:			
Tobacco	$2,349,617	$2,168,242	$2,084,938
Transportation	582,631	450,886	360,656
Other	362,665	338,502	343,386
Total	$3,294,913	$2,957,630	$2,788,980
Earnings from operations:			
Tobacco	$ 434,227	$ 404,487	$ 450,683
Transportation	16,535	31,688	18,242
Other	74,048	52,489	45,131
Total	$ 524,810	$ 488,664	$ 514,056
Interest and debt expense	$ 40,606	$ 30,169	$ 29,694
Provision for income taxes	231,417	234,833	261,626
Net earnings	263,569	231,321	229,065
Per common share:			
Net earnings	5.89	5.17	5.18
Net earnings—assuming full dilution	5.34	4.61	4.60
Dividends	2.636	2.496	2.40
FINANCIAL POSITION			
Working capital	720,473	680,070	747,654
Inventories	835,318	833,917	758,418
Total current assets	1,146,228	1,144,349	1,059,459
Net property, plant and equipment	1,194,562	942,203	758,013
Total assets	2,611,993	2,344,026	2,055,504
Notes payable	46,926	12,455	17,416
Long-term debt (including current maturities)	563,335	537,572	470,357
Stockholders' equity	1,512,183	1,370,661	1,247,200
Book value per common share	34.13	30.91	28.33
OTHER INFORMATION			
Capital expenditures	339,729	252,885	166,499
Depreciation, depletion and amortization	86,800	70,471	68,439
Net earnings as a % of net sales and revenues	8.0%	7.8%	8.2%
Return on average total capital[3]	15.6%	15.3%	16.1%
Return on average common stockholders' equity	18.1%	17.4%	19.3%
Common dividend payout ratio[4]	45%	48%	46%
Average number of common shares outstanding	42,064,408	41,547,108	40,907,239
Average number of common shares outstanding—assuming full dilution	49,321,395	50,140,565	49,780,139
Number of stockholders at year-end	124,371	120,321	126,790

(1) Applicable amounts for years 1964 through 1972 have been restated to reflect the settlement of an issue with the Internal Revenue Service (see Note F of Notes to Consolidated Financial Statements).

(2) Net earnings are after an extraordinary charge (credit) in the years 1969, 1965, and 1964 amounting to $41,151,000, ($6,701,000), and ($1,556,000), respectively. Per common share results before extraordinary items were as follows:

	1969	1965	1964
Earnings before extraordinary items	$3.90	$2.94	$2.69
Earnings before extraordinary items—assuming full dilution	3.63	2.85	2.63

1970	1969	1968	1967	1966	1965	1964
$1,961,817	$1,810,720	$1,802,466	$1,759,243	$1,697,104	$1,659,961	$1,634,496
374,906	280,334	226,383	180,496	147,464	101,782	94,158
303,917	262,447	229,911	216,233	168,961	92,134	42,040
$2,640,640	$2,353,501	$2,258,760	$2,155,972	$2,013,529	$1,853,877	$1,770,694
$ 392,347	$ 325,193	$ 320,370	$ 291,692	$ 263,729	$ 259,781	$ 242,353
38,632	55,853	50,523	33,315	24,312	12,448	9,316
25,331	12,551	13,345	14,668	17,919	8,765	8,657
$ 456,310	$ 393,597	$ 384,238	$ 339,675	$ 305,960	$ 280,994	$ 260,326
$ 31,051	$ 23,092	$ 14,327	$ 16,104	$ 11,823	$ 7,108	$ 7,508
219,045	194,777	196,064	157,723	143,975	136,126	127,114
207,388	134,278[2]	169,195	162,131	148,070	142,359[2]	126,603[2]
4.70	2.87[2]	3.72	3.55	3.17	3.06[2]	2.72[2]
4.22	2.78[2]	3.48	3.36	3.06	2.95[2]	2.66[2]
2.40	2.25	2.20	2.05	2.00	1.85	1.80
588,226	623,566	682,595	622,027	583,479	626,882	672,146
719,817	718,852	732,367	778,325	779,634	772,911	759,084
954,163	937,821	994,225	967,412	953,323	919,290	884,137
690,768	531,465	385,164	354,663	318,804	268,735	197,083
1,908,663	1,702,389	1,453,457	1,449,952	1,378,228	1,240,862	1,093,174
148,746	143,840	111,305	175,500	180,650	125,000	67,000
340,579	298,267	137,125	141,072	132,383	120,467	103,837
1,118,041	1,023,324	1,006,878	927,123	846,995	807,601	760,596
25.62	23.30	22.40	20.43	18.49	17.61	16.52
177,537	200,850	67,650	72,300	86,622	127,079	27,353
62,275	45,959	41,808	38,022	34,239	27,777	30,008
7.9%	5.7%	7.5%	7.5%	7.4%	7.7%	7.1%
15.7%	11.6%	14.7%	14.8%	14.5%	15.1%	14.2%
19.2%	12.6%	17.4%	18.2%	17.8%	18.0%	17.1%
51%	58%	59%	58%	63%	63%	67%
40,242,252	40,235,578	40,235,552	40,302,863	40,800,745	40,528,050	40,968,611
49,188,427	48,123,711	48,184,929	47,784,586	47,844,569	47,800,123	47,073,953
137,504	136,539	136,129	134,038	131,371	118,281	114,010

(3) Net earnings plus interest and debt expense divided by average total capital, excluding vessel construction loans. (Total capital is the sum of stockholders' equity, short-term notes payable, and total long-term debt.)

(4) Dividends per common share as a percentage of earnings per common share before extraordinary items.

CONSOLIDATED BALANCE SHEETS

December 31, 1973 and 1972
(Dollars in Thousands)

	1973	1972 (Note F)
ASSETS		
Current assets:		
Cash	$ 36,041	$ 38,398
Marketable securities (approximate market)	3,655	37,710
Accounts receivable (less allowances of $14,941 and $12,308, respectively)	259,354	226,572
Inventories	835,318	833,917
Prepaid expenses	11,860	7,752
Total current assets	1,146,228	1,144,349
Property, plant and equipment—at cost:		
Land and land improvements	15,796	15,595
Buildings and leasehold improvements	169,119	139,895
Machinery and equipment	307,454	286,048
Vessels, containers and other marine equipment	1,125,030	678,705
Petroleum-producing properties	94,262	94,845
Construction-in-process	56,817	232,626
	1,768,478	1,447,714
Less allowances for depreciation, depletion and amortization	573,916	505,511
Net property, plant and equipment	1,194,562	942,203
Cost in excess of net assets of businesses acquired	163,214	163,465
Other assets and deferred charges	107,989	94,009
	$2,611,993	$2,344,026

See Notes to Consolidated Financial Statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	1973	1972 (Note F)
Current liabilities:		
Notes payable	$ 46,926	$ 12,455
Accounts payable and accrued accounts	218,325	226,330
Current maturities of long-term debt	84,153	173,698
Income taxes accrued	76,351	51,796
Total current liabilities	425,755	464,279
Reserves and non-current liabilities	53,082	46,239
Deferred income taxes	141,791	98,973
Long-term debt (less current maturities)	479,182	363,874
Stockholders' equity:		
Preferred Stock—$2.25 Convertible Preferred Stock—without par value Authorized—7,078,709 shares in 1973; Issued—7,066,759 shares in 1973 and 7,166,509 shares in 1972	74,696	75,750
Common Stock—Par $5 Authorized—60,000,000 shares; Issued—42,113,127 shares in 1973 and 41,898,065 shares in 1972	210,565	209,490
Paid-in capital	45,331	40,566
Earnings retained	1,181,591	1,044,855
Total stockholders' equity	1,512,183	1,370,661
	$2,611,993	$2,344,026

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF EARNINGS

For the Years Ended December 31, 1973 and 1972
(Dollars in Thousands)

	1973	1972 (Note F)
Net sales and revenues	$3,294,913	$2,957,630
Costs and expenses:		
Cost of products sold and operating expenses	2,413,051	2,130,853
Selling, advertising, administrative and general expenses	357,052	338,113
Earnings from operations	524,810	488,664
Interest and debt expense	40,606	30,169
Other (income) expense, net	(10,782)	(7,659)
Earnings before provision for income taxes	494,986	466,154
Provision for income taxes	231,417	234,833
Net earnings	263,569	231,321
Preferred dividends	15,906	16,580
Net earnings applicable to Common Stock	$ 247,663	$ 214,741
Net earnings per common share	$5.89	$5.17
Net earnings per common share—assuming full dilution	5.34	4.61
Average number of common shares outstanding	42,064,408	41,547,108
Average number of common shares outstanding—assuming full dilution	49,321,395	50,140,565

CONSOLIDATED STATEMENTS OF EARNINGS RETAINED

For the Years Ended December 31, 1973 and 1972
(Dollars in Thousands)

	1973	1972 (Note F)
Balance at beginning of year as previously reported		$ 939,447
Less adjustments to years prior to 1972– Note F		5,609
As restated	$1,044,855	933,838
Add net earnings	263,569	231,321
	1,308,424	1,165,159
Deduct cash dividends:		
$2.25 Convertible Preferred Stock	15,906	16,580
Common Stock	110,927	103,724
Total cash dividends	126,833	120,304
Balance at end of year	$1,181,591	$1,044,855

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the Years Ended December 31, 1973 and 1972
(Dollars in Thousands)

	1973	1972 (Note F)
Source of working capital:		
Net earnings	$263,569	$231,321
Add items not involving working capital in the current period:		
Depreciation, depletion and amortization	86,800	70,471
Deferred income taxes	42,818	32,085
Reserves and non-current liabilities	6,843	11,384
Total from operations	400,030	345,261
Proceeds from long-term debt (exclusive of vessel construction loans, classified in current maturities)	216,408	61,409
Proceeds from issuance of Company's stocks	6,301	17,460
Disposals of property, plant and equipment	5,042	2,942
	627,781	427,072
Use of working capital:		
Capital expenditures	339,729	252,885
Cash dividends	126,833	120,304
Long-term debt becoming currently payable	101,100	92,291
Retirement of Preferred Stock upon conversion	1,515	5,016
Other, net	18,201	24,160
	587,378	494,656
Increase (decrease) in working capital	$ 40,403	$(67,584)
Analysis of changes in working capital:		
Increase (decrease) in current assets:		
Cash and marketable securities	$(36,412)	$(49,791)
Accounts receivable	32,782	60,954
Inventories	1,401	75,499
Prepaid expenses	4,108	(1,772)
Decrease (increase) in current liabilities:		
Notes payable	(34,471)	4,961
Accounts payable and accrued accounts	8,005	(76,592)
Current maturities of long-term debt	89,545	(98,097)
Income taxes accrued	(24,555)	17,254
Increase (decrease) in working capital	$ 40,403	$(67,584)

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note A — Summary of Significant Accounting Policies and Related Matters

CONSOLIDATION

The Company includes in its consolidated financial statements the accounts of the parent and all subsidiaries after eliminating intercompany accounts and transactions.

FOREIGN CURRENCY TRANSLATION AND FOREIGN OPERATIONS

Current assets (other than leaf tobacco inventories) and current liabilities denominated in foreign currencies are translated at year-end exchange rates; other assets and liabilities are translated at the prevailing rate when the asset was acquired or the liability incurred. Long-term ship mortgage bonds, which are payable in foreign currencies, were recorded at the U.S. dollar equivalent of the bonds at their issue date. Differences between U.S. dollars required for the principal payments and the recorded bond amount are charged or credited to other (income) expense, net. Foreign currency revenues and expenses were translated at average exchange rates during the year, except that depreciation, depletion and amortization and leaf tobacco costs were translated at the exchange rates in effect on the dates the related assets were acquired. Losses resulting from foreign currency translation are expensed to the extent they exceed translation gains.

During 1972 the Company recognized net foreign currency translation losses of $332,000, all of which were charged to other (income) expense, net, bringing to $960,000 the amount of net translation losses charged against income through December 31, 1972. In 1973, the Company had translation gains of $2,052,000, of which $960,000 was credited to other (income) expense, net, and the remaining $1,092,000 was credited to reserves and non-current liabilities. At December 31, 1973, the U.S. dollar equivalent of ship mortgage bonds would have been $4,527,000 greater if translated at year-end rates rather than at the rates in effect on date of issue.

The financial position of the Company's foreign operations at December 31, 1973 and 1972 and results for the years then ended were as follows:

	(Dollars in Thousands)	
	1973	1972
Assets	$270,623	$222,248
Liabilities	144,382	95,291
Net sales and revenues	460,152	344,584
Earnings from operations	71,886	46,257
Net earnings	28,701	12,690

INVENTORIES

Inventories, principally leaf tobacco, but including supplies and manufactured products, are stated at cost (substantially all on last-in, first-out basis). The current replacement value of inventories at December 31, 1973 and 1972 was approximately $287 and $249 million, respectively, greater than the amount at which these inventories were carried on the balance sheet.

INVESTMENT TAX CREDIT

The Company uses the flow-through method in accounting for investment tax credits, whereby the provision for income taxes is reduced in the year the tax credits first become available rather than deferring the credit over the life of the related asset.

DEPRECIATION

The Company depreciates assets used in the transportation and petroleum businesses using the straight-line method for book purposes and accelerated methods for income tax purposes. Where different depreciation methods are used for book and income tax purposes, provision is made for deferred income taxes which may be payable in future years. For all other assets, depreciation is determined using accelerated methods for the most part for both book and income tax purposes.

OTHER POLICIES

Vessel charter costs for book purposes are expensed on a straight-line basis over the estimated vessel service life (generally 15 years). For tax purposes vessel charter payments are deducted in accordance with charter agreements, which generally provide for an initial 10-year period and renewals thereafter at reduced rates. The difference between charter costs for book and tax purposes is included as a deferred charge on the balance sheet and appropriate provision for income taxes payable in future years has been included in deferred income taxes. The Company has capitalized as SL-7 vessel cost construction loan interest and commitment fees aggregating $28 million, including $8 million in 1973 and $11 million in 1972.

The Company is not amortizing cost in excess of net assets of businesses acquired prior to November 1, 1970, since the Company believes no diminution in these amounts has occurred since the businesses were acquired.

Sales of products are recognized in income as customer shipments are made. Net sales include federal and foreign excise taxes on tobacco products of $964,908,000 in 1973 and $885,318,000 in 1972. The Company's transportation revenues and related voyage expenses are generally recognized at commencement of the voyage.

Generally, the Company's policy is to expense research, development and other costs as incurred.

The Company includes in other (income) expense, net, items of a financial nature, principally interest income.

Note B – Long-Term Debt

Long-term debt consists of the following:

	(Dollars in Thousands)			
	December 31, 1973		December 31, 1972	
	Due Within One Year	Due After One Year	Due Within One Year	Due After One Year
Vessel construction loans[1]	$ –	$ –	$135,475	$ –
7½% Ship Mortgage Bonds, payable in Deutschemarks, with semi-annual sinking fund payments through 1987	13,496	167,725	2,315	30,091
Ship Mortgage Bonds, with interest at 8½% and 8¾% payable in Dutch Guilders, with semi-annual sinking fund payments through 1981	11,391	74,241	3,551	24,856
7⅜% Debentures, due February 1, 2001, with annual sinking fund payments beginning in 1982	–	100,000	–	100,000
7⅞% Debentures, due September 1, 1994, with annual sinking fund payments beginning in 1975	–	100,000	–	100,000
8⅛% Notes, due September 1, 1974	50,000	–	–	50,000
Equipment obligations (6% to 9%), payable in monthly installments through 1978	8,664	17,050	12,845	25,714
7% Subordinated Debentures, due June 1, 1989, with annual sinking fund payments beginning in 1980	–	15,849	–	15,849
Vessel mortgage notes, due in quarterly installments through March 31, 1976[2]	–	–	5,710	12,160
3% Debentures, due October 1, 1973	–	–	13,000	–
Other indebtedness with various interest rates and maturities	602	4,317	802	5,204
	$ 84,153	$479,182	$173,698	$363,874

Payment schedule of debt due after one year:

Due in:

1975	$ 37,978
1976	37,734
1977	32,549
1978	30,293
1979 and later	340,628
	$479,182

(1) Vessel construction loans, payable in Deutschemarks or Dutch Guilders, became due upon delivery of the vessels during 1973 and were refinanced with long-term ship mortgage bonds.

(2) The vessel mortgage notes were prepaid in 1973.

Note C – Commitments and Contingencies

The Company and its subsidiaries are involved in certain litigation and renegotiation matters which in the aggregate are not expected to have any material effect on the Company's financial statements.

The Company had various capital spending commitments of approximately $50 million at December 31, 1973.

Leases and charters for vessels and related equipment and facilities are used extensively in connection with the transportation business. Charters for vessels generally have initial periods of 10 years with renewal periods of up to 30 additional years. Leases for other major equipment and facilities generally have terms ranging from 5 to 20 years.

Noncancelable and cancelable lease expense for 1973 and 1972 was as follows:

	(Dollars in Thousands)	
	1973	1972
Non-Financial leases	$22,277	$14,557
Financial leases	31,367	26,268
Total noncancelable leases	53,644	40,825
Other leases	25,404	18,452
Total lease expense	$79,048	$59,277

At December 31, 1973, the Company was obligated under noncancelable lease agreements to make minimum payments in future years as follows:

	(Dollars in Thousands)		
	Noncancelable Lease Expense		
	Non-Financial	Financial	Total
1974	$23,496	$ 35,653	$ 59,149
1975	15,469	36,100	51,569
1976	11,077	34,415	45,492
1977	9,469	34,046	43,515
1978	7,798	33,915	41,713
1979-1983	15,859	132,696	148,555
1984-1988	2,446	84,428	86,874
1989-1993	375	60,715	61,090
Remainder	165	49,478	49,643

The net present values of the Company's future minimum lease obligations under financing leases at December 31, 1973 and 1972 are shown below by type of property along with the weighted average and range of interest rates specified or implicit in the leases.

	Interest Rates		(Dollars in Thousands)	
			Present Value Amounts	
Property	Weighted Average	Range	1973	1972
Land and Buildings	7%	3%-13%	$110,791	$ 50,959
Machinery and Equipment	7%	7%	259	92
Vessels, containers, and other marine equipment	12%	4%-17%	133,451	121,177
			$244,501	$172,228

If all noncancelable financing leases had been capitalized and the related assets depreciated using the straight-line method over the same period of years used for depreciating similar owned assets, the impact on net earnings would not exceed three percent of the average net earnings for the most recent three years.

Note D — Proposed Acquisition of United States Lines

In October, 1969, Sea-Land Service, Inc., and United States Lines, Inc., entered into a Time Charter and an Agreement of Lease and Sublease under which Sea-Land proposed to charter from United States Lines 16 containerships and to lease related equipment for a period of 20 years with an option to purchase at the end of the period. In November, 1969, American Export Lines, Inc., filed an antitrust suit in the United States District Court for the Southern District of New York seeking a preliminary as well as a permanent injunction against consummation of the charter and equipment lease, seeking an order that R. J. Reynolds Tobacco Company, a subsidiary of the Company, be required to divest itself of McLean Industries, Inc., the parent of Sea-Land, and that Walter Kidde & Company, Inc., be required to divest itself of United States Lines, and asking for treble damages. The request for preliminary injunction was withdrawn in December, 1969, and, by stipulation, the entire case was stayed pending a decision by the Federal Maritime Commission in the proceedings then pending for approval of the proposed charter and equipment lease. In the opinion of counsel, this suit is without merit as to Reynolds Tobacco, McLean and Sea-Land.

On November 9, 1970, an agreement was entered into under which Reynolds Tobacco would acquire all of the Common Stock of United States Lines for a $65 million promissory note payable to Kidde. The note, due no later than November 9, 1976, will bear interest from November 9, 1970, at an annual rate of 8% plus interest at the rate of 6% per annum on deferred installments of interest. Applications for approval of the agreement were filed with the Federal Maritime Commission and the Interstate Commerce Commission. Under the terms of a supplemental agreement with Kidde (which agreement has been disapproved by the Federal Maritime Commission as noted below), if the necessary approvals are not obtained or if the consummation of the transaction is barred by a court order which has become final, Reynolds Tobacco is obligated to produce equivalent consideration for Kidde within 24 months of any disapproval or the entry of such final order, and in any event no later than November 9, 1976, and under such supplemental agreement United States Lines will be sold or disposed of otherwise for the account of Reynolds Tobacco. The acquisition agreement modifies the proposed charter and equipment lease agreement referred to above and provides for termination thereof in the event the proposed acquisition is not approved.

In December, 1970, the Department of Justice filed an antitrust suit in the United States District Court for the District of New Jersey seeking an injunction prohibiting the proposed acquisition and an order rescinding the aforesaid supplemental agreement. The Court denied the request of the Federal Maritime Commission for a stay of proceedings in the suit and held that the Commission does not have jurisdiction to approve the proposed acquisition. The Court entered an order prohibiting consummation of the acquisition and of the supplemental agreement pending further order of the Court. In March, 1973, the U.S. Supreme Court declined to review the lower Court's holding.

In February, 1973, the Federal Maritime Commission issued its decision and report setting forth its approval, subject to certain conditions, of the proposed acquisition and asserting jurisdiction over and disapproving the supplemental agreement, and in March, 1973, the Company filed with the Commission its acceptance of the conditions. The conditions include, among other things, the requirement that United States Lines be operated as an independent carrier in all respects in competition with Sea-Land; that financial support be furnished by the Company to United States Lines; that there be restrictions on future offshore construction, conversion and chartering of vessels by either line; and that there be continuing surveillance by the Commission of the Company's compliance with the conditions of approval. An appeal from the decision and report of the Commission by certain shipping companies, certain labor unions, the Department of Justice (and, as to the assertion of jurisdiction over and the disapproval of the supplemental agreement by the Federal Maritime Commission, by Kidde) is now pending in the United States Court of Appeals for the District of Columbia.

In August, 1973, an Administrative Law Judge of the Interstate Commerce Commission handed down his initial decision that the proposed acquisition should be approved subject to the conditions referred to in the preceding paragraph. Exceptions by other shipping companies were filed to the initial decision, which has not become final. The final determination of the Interstate Commerce Commission is subject to court review.

Since the Company cannot own or operate United States Lines without all required Government approvals, the proposed acquisition cannot be reflected in the Company's financial statements.

The Company believes the outcome of the foregoing matters should have no material adverse effect on the Company's financial statements.

Note E – Capital Changes and Related Matters

	(Dollars in Thousands) 1973	1972
$2.25 Convertible Preferred Stock—without par value ($10.57 per share stated value)		
Balance at beginning of year	$ 75,750	$ 80,199
Shares sold under substitute stock options at prices of $37.25 and $42.50 (43,625 shares in 1973 and 53,650 in 1972)	461	567
Shares converted into Common Stock (143,375 shares in 1973 and 474,538 in 1972)	(1,515)	(5,016)
Balance at end of year	$ 74,696	$ 75,750
Common Stock – Par $5		
Balance at beginning of year	$209,490	$205,931
Shares issued upon conversion of Preferred Stock (215,062 shares in 1973 and 711,805 in 1972)	1,075	3,559
Balance at end of year	$210,565	$209,490
Paid-in capital		
Balance at beginning of year	$ 40,566	$ 27,232
Net proceeds from conversion of Preferred Stock into Common Stock	3,595	11,896
Net proceeds from exercise of substitute stock options	1,170	1,438
Balance at end of year	$ 45,331	$ 40,566

Each share of the Preferred Stock is convertible into 1.5 shares of the Company's Common Stock on surrender of the preferred share and payment of $22 in cash. Upon conversion the cash proceeds and the stated value of the converted preferred shares less the par value of the common shares issued is credited to paid-in capital. The Company may redeem the Preferred Stock after June 30, 1979, at $50 per share (aggregating $353,338,000 at December 31, 1973) plus accrued dividends to the redemption date. In the event of involuntary liquidation, holders of the Preferred Stock are entitled to $10.57 per share plus accrued dividends. Of the authorized but unissued common shares at December 31, 1973, 10,603,139 were reserved for conversion of 7,066,759 shares of preferred shares issued and 2,000 shares issuable upon exercise of remaining substitute stock options (which expired January 7, 1974).

Note F — Provision for Income Taxes

The provision for income taxes consists of the following:

	(Dollars in Thousands) 1973	1972
Current:		
Federal	$119,257	$152,572
State	23,065	21,313
Foreign	46,277	28,863
Total	188,599	202,748
Deferred:		
Federal	39,112	25,275
State	327	91
Foreign	3,379	6,719
Total	42,818	32,085
Total income taxes	$231,417	$234,833

Deferred income tax expense results from timing differences in the recognition of revenue and expense for book and tax purposes. The sources of these differences and the tax effect of each were as follows:

	(Dollars in Thousands) 1973	1972
Excess of tax over book depreciation	$24,157	$19,671
Vessel construction loan interest capitalized	3,829	5,437
Various other items	14,832	6,977
	$42,818	$32,085

The effective tax rate was 46.8% in 1973 and 50.4% in 1972. The differences between the amounts recorded and the amounts computed by applying the federal income tax rate of 48% to earnings before provision for income taxes is explained as follows:

	(Dollars in Thousands) 1973		1972	
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income
Income tax computed at statutory U.S. federal income tax rate	$237,593	48.0%	$223,754	48.0%
Foreign taxes in excess of U.S. foreign tax credits	22,846	4.6	21,268	4.6
State taxes, net of federal tax benefit	12,163	2.5	11,130	2.4
Investment tax credit	(30,180)	(6.1)	(10,072)	(2.2)
Miscellaneous items	(11,005)	(2.2)	(11,247)	(2.4)
Provision for income taxes	$231,417	46.8%	$234,833	50.4%

During 1973, the Company recorded a $19 million net refund of federal income taxes and interest thereon as a result of a settlement of an issue with the Internal Revenue Service. This issue related to the manner in which the Company had applied the last-in, first-out (LIFO) method of pricing inventories in its tobacco business. The effects of the settlement have been accounted for as prior period adjustments, affecting net earnings for the years 1962-1972 by less than 3%, and for the year 1961 by 4%. Net earnings for 1972 were reduced from $237 million to $231 million and earnings per share of Common Stock from $5.32 to $5.17. The aggregate effect for the twelve-year period was a reduction in the carrying value of the Company's inventories of $31 million which, after applicable income tax refunds and interest thereon, resulted in a reduction of earnings retained of $12 million, $6 million of which related to years prior to 1972.

No provision has been made for U.S. income taxes that may be payable upon remittance of earnings retained abroad by foreign subsidiaries, since any such taxes that might be due would be largely offset by foreign tax credits.

There are a number of issues pending as a result of Internal Revenue Service audits, which, in the aggregate, are not expected to have a material effect on the Company's financial statements.

Note G — Pension Plans

The Company administers several pension plans covering a substantial number of its employees. Substantially all of such plans are funded under the aggregate cost method, and the Company's policy with respect to these plans is to fund pension costs accrued. The total expense for these plans for 1973 was $20,182,000 compared with $15,332,000 for 1972. The increase in 1973 resulted principally from a decline in the market value during 1973 of common equity securities held by the pension funds.

The assets of each of the Company's plans exceeded the actuarially computed value of vested benefits according to the most recent actuarial valuations.

In addition, the Company makes payments for various plans administered by labor unions under terms of collective bargaining agreements.

Note H — Net Earnings Per Common Share

Net earnings per common share are determined by dividing net earnings applicable to Common Stock by the average number of common shares outstanding.

Net earnings per common share assuming full dilution are calculated using the treasury stock method for determining fully diluted shares. Under this method, it is assumed that all shares of the Preferred Stock outstanding during the year (plus shares of the Preferred Stock which would have been issued assuming exercise of substitute options) were converted into Common Stock and the proceeds used to purchase treasury common shares at the higher of the average daily price or year-end closing price of the Common Stock.

Note I — Pending Acquisition of Macdonald Tobacco Inc.

In December the Company agreed to purchase the stock of Macdonald Tobacco Inc. for approximately $75 million. Macdonald Tobacco, with annual sales of approximately $250 million, is a manufacturer and distributor of cigarettes, smoking tobacco and cigars with principal activities in Canada. The transaction will be accounted for as a purchase and the accounts of Macdonald will be included in the consolidated financial statements from the effective date of the acquisition.

REPORT OF INDEPENDENT ACCOUNTANTS

ERNST & ERNST

2015 Wachovia Building
Winston-Salem, N.C.

R. J. Reynolds Industries, Inc.
Its Directors and Stockholders

We have examined the consolidated financial statements of R. J. Reynolds Industries, Inc., and subsidiaries for the two years ended December 31, 1973. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheets and statements of earnings, earnings retained, and changes in financial position present fairly the consolidated financial position of R. J. Reynolds Industries, Inc., and subsidiaries at December 31, 1973 and 1972, and the consolidated results of their operations, changes in financial position and changes in stockholders' equity for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

February 12, 1974

Ernst & Ernst

R.J.Reynolds Industries, Inc.

Board of Directors

COLIN STOKES
Chairman,
R. J. Reynolds Industries, Inc.

J. PAUL STICHT
President,
R. J. Reynolds Industries, Inc.

DAVID S. PEOPLES
Vice Chairman,
R. J. Reynolds Industries, Inc.

S. A. ANGOTTI
Senior Vice President,
R. J. Reynolds Industries, Inc.

C. F. BENBOW
Senior Vice President,
R. J. Reynolds Industries, Inc.

A. H. GALLOWAY
Retired Chairman,
R. J. Reynolds Industries, Inc.

GORDON GRAY
Chairman Emeritus,
National Trust for Historic Preservation

CHARLES F. MYERS, JR.
Chairman,
Burlington Industries, Inc.

H. C. ROEMER
Vice President and General Counsel,
R. J. Reynolds Industries, Inc.

J. H. SHERRILL
Vice President,
R. J. Reynolds Tobacco Company

WILLIAM S. SMITH
Chairman,
R. J. Reynolds Tobacco Company

WM. D. HOBBS
President,
R. J. Reynolds Tobacco Company

WALTER L. LINGLE, JR.
Former Executive Vice President,
The Procter & Gamble Company

WILLIAM R. LYBROOK
Senior Vice President and Secretary,
R. J. Reynolds Industries, Inc.

MALCOM P. McLEAN
President,
McLean Industries, Inc.

CHAS. B. WADE, JR.
Senior Vice President,
R. J. Reynolds Industries, Inc.

Officers

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Chairman and Chief Executive Officer

J. PAUL STICHT
President and Chief Operating Officer

DAVID S. PEOPLES
Vice Chairman, and Chairman of the Executive Committee

WILLIAM R. LYBROOK
Senior Vice President and Secretary

S. A. ANGOTTI
Senior Vice President

C. F. BENBOW
Senior Vice President

CHAS. B. WADE, JR.
Senior Vice President

E. C. RITCHELL
Vice President

H. C. ROEMER
Vice President and General Counsel

J. W. DOWDLE
Treasurer

R. A. EMKEN
Comptroller

R.J.Reynolds Industries, Inc.

Registrar

MANUFACTURERS HANOVER TRUST COMPANY
Corporate Trust Division
4 New York Plaza
New York, New York 10015

Transfer Agents

THE CHASE MANHATTAN BANK, N.A.
1 New York Plaza, 14th Floor
New York, New York 10015

FIRST JERSEY NATIONAL BANK
1 Exchange Place
Jersey City, New Jersey 07303

Dividend Reinvestment Agent

THE CHASE MANHATTAN BANK, N.A.
1 New York Plaza, 14th Floor
New York, New York 10015

Stockholder Inquiries

Communications concerning transfer requirements and lost certificates should be directed to either Transfer Agent. Communications concerning dividends and change of address should be directed to R. J. Reynolds Industries, Inc., Shareholder Services Department, Box 2959, Winston-Salem, North Carolina 27102.

Common and Preferred Shares

Listed on the New York Stock Exchange (trading symbol: RJR).

Corporate Headquarters

Reynolds Building
Fourth & Main Streets
Winston-Salem, North Carolina 27102
Telephone: (919) 748-4000

Notice of Annual Meeting

The Annual Meeting of the Company's stockholders will be held on April 24, 1974, in the Gold Ballroom of the Hotel du Pont, 11th and Market Streets, Wilmington, Delaware, at 2:00 p.m., local time. A formal notice of the meeting, together with Proxy Statement and Proxy, will be mailed to stockholders of record at the close of business February 26, 1974.